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ADAPT OR DISAPPEAR: THE CHALLENGES FACING THE INSURANCE INDUSTRY IN THE DIGITAL WORLD

A decisive evolution of the insurance companies' business model

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1.

INTRODUCTION

The banks initiated the movement a few years ago. Faced with the upheavals in the world of finance, low interest rates, and new customer demands, the banking world has made profound changes to its business model and more generally to its way of operating.
The constant search for profit optimization and cost reduction has led banks to migrate more and more of their software solutions to a new digital, delocalized and secure scheme in the Cloud.
A major trend today is the progressive decommissioning of old legacy software, based on a mainframe architecture including client/server networks, functionally powerful but not very flexible in the face of tomorrow's challenges. A very recent example of this is insurer AG Insurance's move from old mainframe systems to a new architecture based on Windows servers and a dedicated data center. Before a possible evolution to the Cloud (IAAS - Infrastructure-as-a-Service).
The insurance world - often closely linked to the bank, in the frequent setting up of «Bank Insurance» - is bound to follow the movement, albeit a few years later. Insurers have long lived on their established model of brokerage networks and «physical» agencies, and of standard products that have proven themselves and are sold without having to advertise too much.
All this indicates that the future challenges are numerous, especially since we are also witnessing the emergence of many new players in the field.

2.

THE RISE OF NEW CHALLENGES

The digital revolution has arrived, and the actors in place must now face multiple evolutions:

- Customers are now used to doing business online (and the Covid 19 pandemic helped accelerate the trend) - they want to be able to manage their insurance policies easily, from their computer, smartphone or tablet.
- The detour via one's broker or agent is no longer systematic, and contacts are often made remotely (telephone, email, social networks). An efficient multi-channel approach is therefore essential to set up
- The trend is not to create a plethora of new products (existing products are still relevant, even if they need to be «dusted off»), but rather either to create targeted products addressing new needs (e.g. Covid insurance, insurance against the increase in airplane fuel prices, insurance against climatic risks), or to highly personalize classic products, to better take into account the client's own characteristics,
- The complexity of the products offered to the customer should be avoided, so that he can easily obtain, at the end of a clear and intuitive digital path, a simulation of his insurance contract, which can be transformed into a final contract in the process.
- This involves a lot of innovation on the part of the insurer:
  - in terms of presentation (clear and to the point display, no pollution by complex data to understand and explain).
  - In terms of managing official acts instantly: digital signature, exchange of sensitive medical data (for life insurance), exchange of proofs and fast reports (for non-life insurance),
  - In terms of monitoring and end-to-end control of the process: a nice encoding in a brand-new front office will have no significant added value if the entire process has not been reviewed, if the back-office systems are not updated to manage all the parameters, if the data collected is not sufficiently relevant and well organized to be used effectively.
  - In terms of reaction, rapid response to the customer. Where we used to be able to wait a few days for a possible agreement from the client following the sending of a paper contract, today we have to manage immediacy, the conclusion in the minute. Without this, the client risks going elsewhere to the competition to find a more reactive insurer.

3.

EMERGENCE OF SMALL AND EFFICIENT INSURTECH PLAYERS

3.1 THE IMMOBILITY OF LARGE INSURANCE COMPANIES

Even though the digital world is on its way, and is profoundly transforming all companies, many of the «majors» in the insurance industry are slow to adapt and to rethink their way of doing business.

Of course, online contract management and web pages dedicated to the consultation of contracts and the presentation of products are appearing, but all too often, the client is led, after a more or less elaborate «wizard», to the last step by having to contact his broker, via the classic channels. We fall back into the classic insurance scheme, even if there is a layer of redesign via a current website or polished PDF presentations.

3.2 FLEXIBILITY AND AGILITY OF SMALL PLAYERS WHO ARE JUMPING ON THE BANDWAGON

Faced with these large companies, we are seeing the emergence of a multitude of small players, often start-ups created by a few entrepreneurial and visionary managers, who want to radically propose a different vision of insurance, and disrupt the sector.

These companies have a scalable and flexible business model, allowing them to quickly seize and integrate new opportunities and transform them into a simple but complete customer-appealing product. They evolve in an agile way, are constantly listening to the market and the new needs that emerge, and manage to raise funds in an impressive way in order to accelerate their growth. However, the world of start-ups is ruthless, whatever the field, and many of these small structures that are hatched will not reach maturity or will not succeed in raising the necessary funds.

Will these small players overshadow the big insurance companies? In principle, no: either they take charge of sectors neglected or not yet invested by the big players, or they propose similar products to these big players, but by addressing a more specific audience (used to digital tools, looking for speed and easy access solutions, attached to advanced customizations,...). Even if it means handing over their business to them (through buyouts, mergers, etc.) once they have reached their goal.

And in this sense, these small structures help the behemoths to evolve by showing them the new axes of growth, and small and large players often collaborate in fine to mutualize their assets:

- Inventiveness, flexibility, performance, cutting-edge expertise in start-ups,
- Extensive networks, distribution channels, notoriety, critical mass, presence abroad,

financing capacity on the part of the existing players.

This is called the «disruptor's dilemma»: the small company benefits from the emergence of a disruption (e.g. the «gig economy», for which delivery services need specific insurance for bicycles, scooters), which are not the preferred targets of the existing insurers. However, the company also depends on the existing players and their solidity to be able to develop and «disrupt» the sector. With the hazards that are often linked to niche markets, and which do not produce enough volume to ensure long-term profitability.

Many of these start-ups are currently in the news, and some of them are quite famous and successful. The challenges are enormous to turn a start-up into a successful company, and even more so if it is to become a «unicorn» (an unlisted company valued at more than 1 billion dollars).

4. INSURANCE START-UPS - ANALYSIS OF THEIR CHARACTERISTICS

We will examine the different characteristics of successful startups from 3 fundamental aspects, and with the help of concrete examples demonstrated by the Belgian-based companies Qover (https://www.qover.com) and Yago (https://www.yago.be):

- **Financial aspect:** the levers for successful and sustained growth,
- **Technical aspect:** «customized» solutions, emergence of new products and services, calls to APIs and modular platforms,
- **Regulatory and legal aspect:** to be at all times in conformity with the Belgian / European / International rules which are in constant evolution.

4.1 FINANCIAL ASPECT.

This is obviously the keystone of the business model to hold an innovative and sustainable solution. It is important to be able to generate profits quickly in order to finance the investments made and the expected growth, and thus show the market the company's capabilities.

- Qover for example, is a player that acts as an intermediary, a digital broker and interposes itself between the end customer and the company or companies that cover the risks. Qover started a major fundraising of €1.5 million in 2016 with entrepreneurs (business angels) from the Belgian FinTech (Ogone, Keytrade Bank, Callataÿ & Wouters); cf. also https://www.lalibre.be/economie/entreprises-startup/2021/10/09/si-qover-etait-rentable-on-se-ferait-virer-demain-A5U7U55625EDNDS7TLVUGVD6NU.

Then an additional fundraising of €5.5 million with an InsurTech fund in Las Vegas followed in October 2016. Since 2016, Qover turnover has been multiplied by 3 each year and the amount raised now exceeds the 35 million €.

The goal of fundraising is to fuel the company's growth by financing positive net present value projects. The return on investment for such a venture capital is 10 to 12 years, so this time is used to inflate the company's capacities to the maximum.

Qover earns commissions on transactions, and the digitization of the customer journey generates substantial savings for operational management. One of the keys is the architecture of the remuneration model, which must be efficient enough to allow sufficient revenues but also offer a competitive advantage to offer attractive prices to customers. This

balancing act is at the heart of the recipe for successful start-ups.
Thus, having a satisfactory financing and a solid business plan on the long term are the necessary conditions of success for the start-ups which launch themselves in this pointed field.

- **Yago** (formerly called Séraphin) is a 100% digital insurance broker. The company offers a reference platform for insurance in Belgium that allows you to manage everything in one place:
  - compare and buy insurance online,
  - manage them from your personal space,
  - declare and follow up your claims while being advised and defended by experts.

Thanks to its collaboration with the insurance industry in Belgium, Yago offers car, motorcycle, home and life insurance policies.
An initial fundraising event took place in 2017, which helped finance the company's growth.
A second round of financing took place before the first confinement (Covid period) : this financing allowed Seraphin to expand the teams to accelerate and validate many key hypotheses for the future of Seraphin.
A third round of financing of €2.2 million has just been carried out in 2022 in order to consolidate on the Flemish market. This should lead to the creation of 20 new jobs.
The originality of the solution, with a specifically Belgian character, has enabled the loyalty of more than 8,000 customers in Belgium, who are sensitive to the digital world and online products, and who are sensitive to data privacy.

4.2 TECHNICAL ASPECT

One of the fundamental differences between InsurTech and traditional insurers is the high degree of digitalization of processes. All interactions with the customer must be managed online, via the various current digital channels: e-mail, chat, social networks, with «responsive» websites that can be consulted from a PC, a tablet or a smartphone.
The current trend is to set up efficient digital platforms to generate integrated ecosystems via the process called «platformization», which allow new market entrants to offer diversified services. Technically this will be done by making business services available via the web (Insurance as a Service - Iaas, via APIs («Application Programming Interface»)), with the necessary layers for data transmission and security.
If the threat they represent for existing insurers is still very relative, these companies are in fact forcing existing insurance players to modify their processes by accelerating their digitalization. In this sense, the traditional players are being «pushed in the back» by the new entrants, and have no other way out than to advance towards digitalization at full speed, at the risk of being completely outdistanced.

- **Qover**, as a Business to Business to Consumer digital broker (B2B2C: online exchanges via an intermediary), creates products itself, unlike a traditional broker. These products, to be attractive, must be :
  - Diversified,
  - Adapted to the customer's expectations («customization»)
  - Offered to new partners: Such as the food delivery platform Deliveroo, the bike manufacturer Cowboy, Poppy cars from D'Ieteren, neobank Revolut, with additional customization possibilities if needed.

For the moment, there are no products with the brand name «Qover». In fact, the modules corresponding to the different solutions take the name of the domain they deal with, e.g.: «Purchase Protection», «Refund Protection», «Rider Accident», «Rider Sickness», «Bike, «Auto», etc. Depending on the client's request, the product of the insurer best suited to meet this particular request will be proposed (amongst the Qover partners: NN, Baloise, etc.)

- **Yago**, as a 100% digital broker, offers insurance products in a variety of fields, which are different from traditional products. In fact, in addition to the usual products (car, home, life and mortgage insurance in particular), Yago offers an original E-reputation insurance, a 100% online motorcycle insurance or a bicycle insurance. In short, products that are different from what you would find in a traditional insurance company.

Via the platforms, there are even differentiated packaging according to the sector of activity, the profession of the customer, etc.
For example, for the delivery of goods to homes by couriers, in the «gig economy», there is an insurer:

- For the equipment (the bike used for the trip),
- For the delivery person himself,
- For what is delivered

This can lead to possible agreements between providers, multi-homing on platforms (similar services being found on several platforms), and also increased competition. We are also moving away from the traditional distribution channels: brokers, agents, a banking channel or a website. The possibilities offered by digital tools open up new horizons for the insurance world, and we can imagine new products in line with new needs.

For example, embedded insurance (insurance linked to the purchase of a good or service) will allow a high level of integration and real-time connection. A purchase of a vacation, a phone... will be directly linked to the easy subscription of an insurance covering the purchased good. Linked to the challenges of the new mobility, tourism, the world of work - split between working at the employer and homeworking, we can easily imagine future evolutions of insurance products, which tend to be widely acclaimed by the public for the ease of underwriting and management.

4.3 REGULATORY ASPECT

The insurance sector - like the banking sector - is highly regulated and subject to multiple directives that evolve over time. It is necessary to ensure the quality of the customers and to limit the risk at this level (Know Your Customer (KYC) and Anti-Money Laundering (AML) regulations in particular).

It is also necessary to comply with many restrictive legislative texts relating to the insurer's business. Let's mention for example some structuring directives for this sector:

- the Insurance Distribution Directive (**IDD**), which regulates the distribution of insurance products. One of the main objectives is to provide a set of rules to ensure enhanced customer protection.
- The European Directive on Markets in Financial Instruments (**MiFID**), which regulates investment products and services, in order to protect investors, promote transparency in financial markets and further harmonize them.
- Packaged Retail Investment and Insurance Products (**PRIIPs**), which has regulated key information documents for insurance-based investment products since early 2018.

- **Solvency II,** which aims to better adapt the capital required of insurance companies to the risks they incur in their business.

There are many more, plus more or less binding directives related to cybercrime for example.
This regulatory aspect makes the work of digital companies somewhat more complex. Indeed, if the API/platform does not take care of the verification of the compliance with the existing legislations, it is up to the insurer itself to do this work and to transmit the relevant information to the platform.
For example, for KYC, it is expected that the company in contact with the customer knows what risks are covered and not covered, and who to contact in case of a claim. This kind of information exchange must be mastered when setting up the API.
The same applies to AML: how can we be sure that the data transmitted by the client is valid? A proper and thorough verification must be done. And also for the other regulatory aspects: either the API/platform performs the necessary checks, or they are deferred to the insurer. The latter is very often the case, as the compliance rules are often complex and the platform/API does not always have all the necessary data for these checks.

It should be noted that we are currently witnessing a constant increase in regulations, which often results in a wave of concentration of companies, a de facto globalization. It is therefore possible that in the coming years, we will see concentrations of InsurTech start-ups caused by this regulatory management.

5. POSSIBLE EVOLUTIONS OF THE BUSINESS MODEL

We have seen that start-ups in the insurance field can progress rapidly by staying in tune with the market and continuously adapting to new customer demands and technological innovations. These are the main reasons why they are different from the more «monolithic» traditional insurance companies.

The development is closely linked to the financing and the rapid availability of important capital to the company. This is the path chosen by Qover, which for several years has been growing more than steadily by raising funds from companies active in this field (venture capital).

We can also think of some possible future developments at the level of the company's «core business»:

- A disruption in the brokerage possibilities: offer more and more diversified products, customized to the needs of the client.
  Examples:
  - *Pay-as-you-go insurance:* the insurance premium is calculated according to the use of the associated product or service,
  - *Parametric insurance:* the compensation is automatically triggered by the public or private indexes or IoT sensors used (i.e. when a predefined triggering threshold has been reached. In the event of a claim, no need to make a declaration, the insured is automatically compensated).
- Complete handling of the customer relationship: the customer journey from A to Z is carried out via the platform and there is no interaction with the final insurer (for example, for the handling of claims, or for more specific business cases),
  Example:
  - Digital architecture enhancing the customer experience with an interconnected platform of communication features such as live chat, voice calls, video meetings and co-browsing tools (for document upload, questionnaire filling, digital signature, etc.)
- The Claims Management,
  Example:
  - the use of artificial intelligence in the sorting of incoming mail and e-mails at the insurance company DAS. By automating the processing of incoming information, multiple processes can then be improved and the response time to the broker is drastically reduced (cf. https://www.sagacify.com/news/the-added-value-of-ai-and-sagacify-proudly-featured-in-fokus-online-magazine).
- Initiatives in all areas of insurance (life / non-life). It can be seen that often the management of life insurance (and the management of

medical records and related investment products) is still left out by InsurTechs, which are rather profiling themselves in the non-life domain,
Example:
- *Developing the use of Big Data API's:* the collection of health data with the consent of the patient (via smartphone or secure health monitoring applications) to provide accurate data on the patient's risk profile, without the need for lengthy questionnaires or medical examinations.

- Positioning in emerging or niche areas where few insurers are active, such as the "Embedded Insurance" (as envisioned by Qover), which consists of wrapping insurance products around the consumer's purchase.
Example:
  - As already mentioned above, when purchasing a new smartphone online, the customer is also offered insurance to cover the loss or theft of their phone.
  - Embedded insurance solutions for the gig economy: when they are working, the meal delivery service riders (Deliveroo, Uber Eats,...) need a good protection: a cover in case of an accident, another cover in case of sickness.

- On the contrary, position yourself on the initially targeted segment in order to cover the segment considered (scaling up).

- Consider a geographical expansion: establish a presence in other European or even global markets.

It is clear, however, that expanding can also mean stepping on the toes of incumbent insurers, who remain vigilant about maintaining their market share. The current coexistence between InsurTechs and insurers works as long as each player finds its own way, and that synergies benefit everyone.

6.

INSURTECHS: WHAT ABOUT THE LONG TERM?

By analogy with the banking industry, many startups have disappeared once the incumbent players have set up shop in the digital domain. So InsurTechs need to build their future in a solid way, with a long-term view.

Some of them might only have a short- and medium-term plan, with the ultimate goal of building up a nice capital for a future buyout or integration into a large structure. This is often the evolution over time of a large number of digital start-ups.

Companies wishing to remain autonomous may then consider raising capital (in the Qover fashion), or acquiring shares to increase their critical size.

7.

AS A CONCLUSION...

The life - and survival - of these Insurtech start-ups depends on their long-term strategy. The ones that survive will be those that have been able to best decode the market's evolutions and that will offer in the future an offer in phase with the emergence of new needs - and therefore also with the consumers' expectations.

Current examples (such as Qover and Yago, but many other ones are emerging) show that these start-up models are on the rise, provided they are properly managed, offer innovative solutions and have a clear vision for their future.

8.

HELP & SUPPORT VIA SQUARE & INITIO

Please note that for any actor active in these insurance and banking fields, our Square group can provide relevant answers and support according to the needs.

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